



EX PARTE CASE NO. 96-45

Celia Nogales
Director - Federal Relations

November 12, 1998

RECEIVED

NOV 12 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
The Portals
445 12th Street, SW
Washington, DC 20554

Re: Ex Parte Filing
Federal-State Joint Board on Universal Service
CC Docket 96-45

Dear Ms. Salas:

On Tuesday, November 10, 1998, Mr. Tom O'Brien, Mr. Dave Zuro, Mr. Carl Creagh and Mr. Harry Albright of Ameritech met with Mr. Scott Potter, Ms. Doris McCarter, Mr. Jeff Jones, Mr. Steve Puican, Mr. Dan Shields, and Mr. Steve Cheney of the Public Utility Commission of Ohio staff to discuss Ameritech's position on intrastate Universal Service high cost fund issues. The attached material was used as part of our discussion.

Sincerely,

A handwritten signature in cursive script that reads "Celia Nogales".

Attachment

cc: D. McCarter

Noted/Checked/Rec'd 022
11/12/98

STATE UNIVERSAL SERVICE

Ameritech's Approach

Presentation to
Public Utilities Commission of Ohio

November 10, 1998

STATE UNIVERSAL SERVICE

What are the Goals?

- ◆ TA96 has two fundamentally important and related goals:
 - Promote competition in all telecommunications markets
 - Rates that are below costs and rates that are above market levels are barriers to competition
 - Implicit subsidies in rates are incompatible with competition
 - Rates that are not based on cost causation and/or recover costs in an economically irrational manner will promote uneconomic competition
 - Preserve and Advance Universal Service
 - Must ensure that any subsidies necessary for Universal Service are explicit, not implicit
 - Must ensure that rates are affordable, reasonably comparable, and that no cross-subsidies exist
 - States and FCC have a joint responsibility to preserve and advance Universal Service

State Universal Service

How do you reach the goals?

- ◆ Take a “tops down” approach
 - “Bottoms up” approach won’t drive best solution
 - Piece parts won’t magically create a desirable or sustainable “whole”
 - Must be a blue-print of the “whole” and how pieces fit together
 - Getting caught up in details can make goals seemingly unreachable
- ◆ Transitional steps may be necessary to reach goals
 - Intermediate steps can be used for distant goals
 - Can transition from current situation to ultimate goals where gap is large
- ◆ Do not predetermine outcome

Issues That Need To Be Addressed

- ◆ Rates that are below costs
- ◆ Rates that are above market levels because of past regulatory policies
- ◆ Implicit subsidies in rates
- ◆ Rates that are not based on cost causation
- ◆ Rates that do not recover costs in an economically rational manner, e.g., NTS costs recovered through traffic sensitive charges
- ◆ Current industry proposals
- ◆ Local Service Guidelines

Why Issues Need To Be Solved

- ◆ To encourage competition to develop as envisioned by TA96
 - Rates below cost discourage competitive entry for residence
 - Rates above market levels create uneconomic and unsustainable entry for other services
 - Implicit subsidies cause rate distortions and uneven competitive entry
 - Rates not based on cost causation cause market distortions
- ◆ To allow customers to be able to take full advantage of rational rates
 - Constrains maximum use of network
 - Heavy users paying too much because of implicit subsidies
 - Urban users may be overpaying
- ◆ To encourage efficient network deployment
 - Non-Cost based rates send wrong economic signals

25/75 Myth

- ◆ Myth that FCC is funding only 25% of total high cost needs and state must create a fund that cares for other 75%.
- ◆ In truth, “25%” is merely used to indicate that FCC is addressing only that portion of HCF over which it has authority.
 - Separations rules allocate approximately 25% to interstate.
 - This is same 25% FCC has always addressed relative to HCF mechanisms.
 - FCC will continue to address 100% of the costs that have traditionally been allocated to its jurisdiction.
 - Federal fund would actually increase from \$1.7B in 1998 to an estimated \$2.9B in 1999.
- ◆ Second part of myth is that “75% left to the states” is an additional revenue need not existing today.
 - Necessary state support is currently being provided
 - Most of support is embedded in rates as implicit subsidies, not from an explicit fund.
 - Federal HCF is taking dollars being collected implicitly (e.g. from carrier access charges) and moving them to an explicit funding mechanism.
 - States need to look at current subsidy flows and decide where these are best recovered through rate rebalancing and explicit funding if any needs continue.

Ameritech's Proposed Goals

- ◆ All rates cost-based and economically rational
 - Fosters a competitive marketplace for all
 - All rates become market driven and sustainable
 - Implicit subsidies removed, e. g. carrier access charges, toll, business, others
 - Rate changes may be transitioned where necessary
- ◆ No expansion of federal support to states
 - States must address own needs first
 - Bigger funds remove incentive to develop cost-based, economically rational rate structure
 - Penalizes states that have already taken steps to fix rates

Ameritech's Proposed Goals (cont.)

- ◆ Narrowly targeted competitively neutral support programs only where necessary
 - Assures telecommunications service for all who want it
 - Includes low income persons and areas with prohibitively high costs
 - Limited to demonstrated need
 - Creation of a State Fund is a “last resort” to be implemented only after rate rebalancing/transitional process has been instituted
 - State Fund may not be needed until competition develops
 - Amount of support adjusted downward as rates are rebalanced
 - Support programs should encourage efficient investment

What the FCC Is Doing in the Interstate Arena

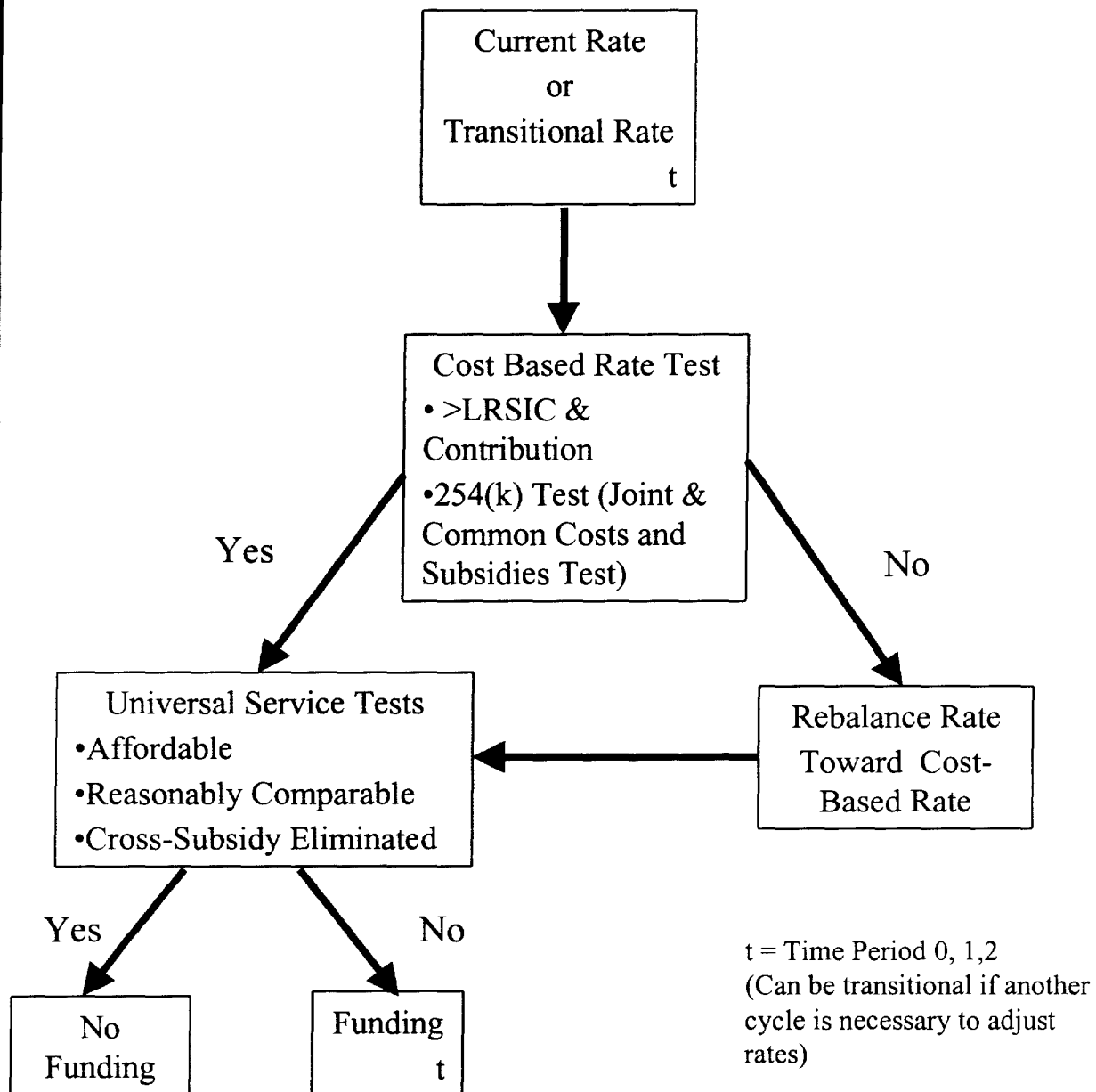
- ◆ Moving toward a competitive market by:
 - Making implicit support explicit
 - Moving toward more cost causative pricing
 - Making support programs portable among eligible telecommunications carriers
 - Establishing means for carriers to recover funding obligations
 - Rebalancing interstate rates for which they have jurisdiction
 - Recognizing that marketplace will drive access charges to cost-based economic prices
- ◆ Preserving and Advancing Universal Service by:
 - Revamping low income LifeLine and Link-Up programs
 - Targeting to needs - cost studies, benchmarks, low income eligibility standards, etc.
 - Establishing a foundation for the states

UNIVERSAL SERVICE

Steps to Reaching Goals

- ◆ Illustrated on attached flow chart
 - Test current rates against LRSIC and 254(k) Joint and Common cost allocation requirements
 - Rebalance those rates not meeting cost tests
 - Conduct universal service tests on current or rebalanced rates
 - Affordable
 - Reasonably comparable
 - Cross-subsidy eliminated
 - Funding limited to services whose rates don't meet universal service tests
 - For funded services, continue transitional rate rebalancing
 - Establish funds in a competitively neutral manner

UNIVERSAL SERVICE Rate Test



Universal Service Tests

◆ Cost Based Rate Test

- LRSIC - price for service must fully recover all direct incremental costs
 - Establishes price floor, not proper price
- 254(k) Joint and Common Cost Allocation-Service defined as a universal service should recover no more than the average contribution of all of the company's services
- Recognizes also that services defined as a universal service should be allowed to recover their fair share of joint and common costs

Universal Service Tests

◆ Affordability Test (254b)

- Affordability best measured by penetration rates
 - Demand elasticity studies will predict if rate increases remain affordable
 - Affordability levels change over time, e.g. as economy changes, inflation, etc.
- Affordability should not be measured to the lowest common denominator, i.e. rates need not be set at the lowest level to meet needs of the lowest income person
- Low income programs provide assistance to meet these needs
- Affordability not limited to basic rates

Universal Service Tests

◆ Comparability Test

- TA96 states rates must be “reasonably comparable”
- Reasonably comparable does not mean equal
- Arbitrary measures (e.g., one rate cannot be more than 175% of another) would have no cost or economic basis and would perpetuate implicit cross subsidies
- Comparability should be defined as “not arbitrary” and having same cost/price relationship

Universal Service Tests

◆ Cross Subsidies Test

- Test if any non-competitive service is priced below LRSIC.
- Test if any competitive services are priced below LRSIC. If all company's competitive services are priced above LRSIC, no non-competitive service is providing a subsidy to a competitive service.

Competitive Neutrality

- ◆ Means USF rules and guidelines neither unfairly advantage nor disadvantage one provider over another, and neither unfairly favor nor disfavor one technology over another
- ◆ Must be a three part test:
 - Funding
 - Recovery
 - Ability to receive funds
- Funding
 - Levies to support a state universal service fund must be assessed on all telecommunications providers based on each provider's relative proportion of the chosen funding basis
 - All telecommunications providers must be subject to the assessment; however, each provider's assessment will vary based upon the relative share that each provider has of the revenue included in the funding base (e.g., local providers may have a zero assessment if the funding basis is interlata toll revenue)

Competitive Neutrality (cont.)

- Recovery
 - All carriers must be given an equal opportunity to recover USF funding obligations
 - Most competitively neutral recovery: a separate line item on all end users' retail bills
- Any shift in funding basis must be revenue neutral to all carriers; i.e., no "windfalls" as a result of the shift For example, consider a carrier whose current contribution to the subsidy of \$3M, recovered through rates, is changed into a \$1M contribution recovered through a line item on the end-user bill:

	<u>Current</u>	<u>Future</u>
1 Subsidy Contribution	\$3,000,000	\$1,000,000
2 Amount recovered through rates	\$3,000,000	\$3,000,000
3 Amount recovered from end users via line item	\$0	\$1,000,000
4 Amount of Overrecovery (Ln2 + Ln3 - Ln 1)	\$0	\$3,000,000

- ◆ The carrier in the above example must be required to pass through the entire \$3M in reduced rates in order to avoid receiving a windfall.

Competitive Neutrality (cont.)

- The “windfall” can result even if there is no end-user line item recovery. In the above example, suppose that the recovery mechanism remains the same even as the carrier’s obligation is reduced from \$3M to \$1M:

	<u>Current</u>	<u>Future</u>
1 Subsidy Contribution	\$3,000,000	\$1,000,000
2 Amount recovered through rates	\$3,000,000	\$3,000,000
3 Amount of Overrecovery (Ln2 - Ln 1)	\$0	\$2,000,000

- In this case, the carrier must be required to pass through the \$2M reduction in funding obligation in reduced rates in order to avoid receiving a windfall

Competitive Neutrality (cont.)

- Ability to receive funds
 - Carriers withdrawing from a USF fund must fulfill all fund obligations
 - Serve all who request the supported service
 - Follow any applicable pricing/service guidelines
 - Be subject to any service standards which might apply
 - Have the same entry and exit restrictions
 - Carriers must first address needs through rate rebalancing
 - Carriers whose rates are not rebalanced who choose to compete in another carrier's serving area should not be eligible to receive support from a state fund

State Universal Service How to Proceed

- ◆ Resolve Legal Question
 - Does the PUCO have the legal authority to require all telecommunications providers and/or customers to contribute to a universal service fund?
- ◆ Local Service Guidelines
 - Do the Local Service Guidelines need to be clarified in any way to further the goals of competition and universal service?
- ◆ Small Company Proposal
 - How does the small company proposal for a universal service fund (OUSF) further the goals of promoting competition and preserving and enhancing universal service?

State Universal Service Local Service Guidelines

Ameritech has the following concerns with the PUCO Local Service Guidelines on Universal Service:

- ◆ Inclusion of a minimum bit speed rate in the universal service definition
- ◆ A benchmark rate should be established concurrently with rate rebalancing and affordability standards
 - A benchmark rate that is too low provides no incentive for companies to rebalance rates and could lead to an extremely large fund
- ◆ Potential “obsolescence” of BCPM model
 - With the FCC adoption of its cost model, it is not clear what the future of BCPM will be

State Universal Service Local Service Guidelines (cont.)

- ◆ Contributions to the fund should be based on end-user retail telecommunications revenue
 - Inclusion of wholesale revenue, such as carrier access, leads to “double counting”
 - Non-telecommunications service revenues, such as yellow pages, should not be included
- ◆ No provision for recovery of contributions (e.g., end-user surcharge)
- ◆ Requirement that only ILECs have COLR obligations
- ◆ Commission authority to impose such a program is questionable

State Universal Service Ameritech Response to Small Company OUSF Proposal

- ◆ Purpose of a State Universal Service Fund
 - Purpose should not be to “keep whole” but to ensure that affordable service is provided in high-cost areas where rebalanced, cost-based rates are unaffordable
- ◆ TIC Recovery
 - Shift from TIC to Tandem Switching is appropriate: non-tandem providers should not recover tandem switching costs
- ◆ Rate Banding
 - Rate banding is appropriate: allows for proper cost recovery based on small company cost structures
- ◆ Rate Rebalancing
 - Rate rebalancing should be required. Benchmark rates can be phased-in over a 3-year period
- ◆ Other potential additions
 - Other costs such as Network/OSS investments, calling area/EAS changes, impacts of competition, etc. should not be included in the Fund

State Universal Service Desired Outcomes

- ◆ Rebalanced rates for all services such that all rates cover incremental costs plus a reasonable contribution
- ◆ Rates for Universal Service which meet affordability, comparability, and cross-subsidy tests
- ◆ Minimal, explicit subsidies only where rebalanced rates are unaffordable
- ◆ Highly targeted Lifeline customer support where rebalanced rates are unaffordable
- ◆ No state universal service fund
 - However, if needed, any fund should be very small and designed to phase out over time as rates are rebalanced
 - Any fund should permit recovery of contributions from end users
 - Contributions to any fund should be assessed such that they do not disadvantage one provider over another for any given service, nor result in new support flows or windfalls to any provider
- ◆ Robust competition in all telecommunications markets, including residential basic local service